SUPREME COURT, U. S.

Office-Supreme Court, U.S.
FILED
JAN 10 1964
JOHN F. DAVIS, CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 624

TEMESCAL WATER COMPANY; and JAMES A. STEIN, on his own behalf and on the behalf of shareholders of Temescal Water Company,

Petitioners,

vs,

THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,

Respondent.

On Petition for Writ of Certiorari to the Supreme Court of the State of California

Brief for Public Utilities Commission of the State of California in Opposition

RICHARD E. TUTTLE
J. THOMASON PHELPS
MARY MORAN PAJALICH
HECTOR ANNINOS
5072 State Building
San Francisco 2, California

Attorneys for Respondent Public Utilities Commission of the State of California and the People of the State of California

SORG PRINTING COMPANY OF CALIFORNIA, 180 FIRST STREET, SAN FRANCISCO 5

SUBJECT INDEX

	Page
Opinions Below	1
Jurisdiction	2
Statutes Involved	2
Argument	2
I. The Decision Is in Accord with the Evidence and Is Reasonable in the Circumstances	2
1. Temescal's Proposed Non-Profit Rate Structure	2
2. The Rate Proposal of the Commission Staff	5
3. The Evidence	6
II. Temescal's Claim That Decision No. 65115 Impairs the Obligation of Contract Is Not Properly Before This Court	10
Conclusion	14

TABLE OF AUTHORITIES CITED

Cases	Pages
Allen v. R.R. Com., 179 Cal. 68; 175 P. 466 (1918)	13
Calif. v. Taylor, 353 U.S. 553, n. 2 (1957)	7
Corona City Water Company v. Publ. Util. Com., 54 Cal. 2d 834; 357 P.2d 301 (1960)	2, 3, 11, 13
Gagnon Co., Inc. v. Nevada Desert Inn, 45 Cal. 2d 448; 289 P.2d 466 (1955)	12
Law v. RR Com., 184 Cal. 737; 195 P. 423 (1921)	11
Lawn v. United States, 355 U.S. 339 n. 16 (1958)	7
Manigault v. Springs, 199 U.S. 473 (1905)	12
Midland Realty Co. v. Kansas City Power & Light Co., 300 U.S. 109 (1937)	11
Producers Transportation Co. v. RR. Com. of the State of Calif., 251 U.S. 228 (1920)	12
Publ. Util. Com. v. United Fuel Gas Co., 317 U.S. 456 (1943)	6
Sutter v. General Petrol. Corp., 28 Cal. 2d 525; 170 P.2d 898 (1946)	12
Transcontinental & W. Air v. Civil Aero. Board, 336 U.S. 601 (1949)	6
Union Dry Goods Co. v. Georgia Publ. Serv. Corp., 248 U.S. 372 (1919)	12

Statutes	
Calif. Constitution, Art. XII, Sec. 23	2, 3, 11
Calif. Public Utilities Code:	
Sections 451-495	3
Section 454	6

Other Authorities	
1 Davis, Admin. Law Treatise, § 5.08 (1958)	6
12 Cal. Jur. 2d ¶ 213	12
Re Pacific Tel. & Tel. Co., Decision No. 43145, 48 CPUC 823, (1949)	6

In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 624

TEMESCAL WATER COMPANY; and JAMES A. STEIN, on his own behalf and on the behalf of shareholders of Temescal Water Company,

Petitioners,

vs.

THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,

Respondent.

On Petition for Writ of Certiorari to the Supreme Court of the State of California

Brief for Public Utilities Commission of the State of California in Opposition

OPINIONS BELOW

Petitioners ask review of Decision No. 65115 (60 Cal. P.U.C. 669 (1963)), dated March 19, 1963, of the Public Utilities Commission of the State of California, as affirmed without opinion by the Supreme Court of the State of California on August 20, 1963.

Decision No. 59443 (57 Cal. P.U.C. 474 (1959)) of the Public Utilities Commission of the State of California and

the opinion of the Supreme Court of California in *Corona City Water Company v. Public Utilities Commission*, 54 Cal. 2d 834; 357 P.2d 301 (1960), are improperly included under the heading "Citation of Opinions Below", page 1 of petition. Said decision and opinion are not the subject of the review sought here, having long been final and *res judicata* as to the issues raised therein.

JURISDICTION

The jurisdictional requisites are adequately set forth in the petition.

STATUTES INVOLVED

Cited at page 3 of the petition, and set forth in Appendix B thereof, is Article XII, Section 23 of the Constitution of the State of California. That section undertakes generally to define what constitutes a public utility. It is submitted that in this respect the section has no relevance in this proceeding since the issue of whether or not petitioner Temescal Water Company is a public utility was determined in the affirmative by Decision No. 59443 (57 Cal. P.U.C. 474 (1959)) of the Public Utilities Commission of the State of California, and by the Supreme Court of California in *Corona City Water Company v. Public Utilities Commission*, 54 Cal. 2d 834; 357 P.2d 301 (1960), such decision and opinion having become final.

ARGUMENT

I. The Decision Is in Accord With the Evidence and Is Reasonable in the Circumstances.

1. Temescal's Proposed Non-Profit Rate Structure.

Decision No. 59443 (Appendix A to petition for writ), issued by respondent Commission on December 29, 1959, found Temescal Water Company to be a public utility sub-

ject to the jurisdiction, supervision and control of the Commission. That finding of public utility status was affirmed by the Supreme Court of California in *Corona City Water Co. v. Public Utilities Commission*, 54 Cal. 2d 834; 357 P.2d 301 (p. 13 of petition for writ), on November 25, 1960, (rehearing denied December 21, 1960). No further appeal was taken and Decision No. 59443 and the opinion of the California Supreme Court have, of course, long since become final. The effect of the foregoing was to subject petitioner to the jurisdiction of this Commission as set forth and defined in the Constitution of the State of California and the Public Utilities Code of California. This jurisdiction extends generally to rates and charges of public utilities. (Article XII, Sect. 23, Constitution of the State of California Sections 451-495, Public Utilities Code of California).

Pursuant to the Commission's rate jurisdiction, Decision No. 59443 reopened the proceeding for the purpose of determining the original cost of the water system properties used in public service, together with the depreciation reserve requirement applicable thereto, and the establishment thereafter of just and reasonable rates (petition for writ, p. 17). Original cost and depreciation studies and determinations are, of course, necessary before rates can be fixed upon the usual rate base and rate of return method.

It is clear from reference to letters attached as Exhibits E, F and G to Temescal's petition for writ of review to the California Supreme Court (Tem. R. pp. 62-67),[1] that on February 8, 1962, well more than one year after Decision No. 59443 was affirmed, Temescal was still attempting to complete the necessary plant and depreciation studies with

---

1. References to the record will be as indicated in the footnote at page 4 of the petition for writ.

the assistance of a person possessed of no experience in public utility rate proceedings. By March 6, 1962, it had become apparent to Temescal that they would have to start again with their studies with the assistance of a qualified engineering advisory firm (See Tem. R. pp. 65-66), but that the additional time required would necessitate taking the proceeding off calendar for an indefinite period. At page 66 (Tem. R.) Temescal expressed its willingness to proceed with a limited presentation, if the Commission was agreeable, upon a May 1962 date which Temescal had proposed in a prior letter (Tem. R. p. 64). In a reply letter (Tem. R. p. 67) the Commission agreed to a procedure contemplating a limited showing to result in interim or temporary rates, to be followed by further hearings at a later date when Temescal's comprehensive studies were completed, after which a different and final order might issue. That Temescal fully understood and consented to this method of proceeding is also evident from a portion of its counsel's opening statement which is quoted in this Commission's answer to the petition for review directed to the California Supreme Court (Tem. R. p. 102; see also Tem. R. pp. 18-19).

At the hearings Temescal made its novel proposal for "non-profit rates". Temescal claimed that as a nonprofit mutual water company it had been exempt from the federal income tax, as well as receiving certain other tax benefits for non-water operations. Since Temescal's stockholders and consumers were one and the same, no advantage could be gained by earning a return on investment for stockholders when the money would have to come from increased rates to the stockholders themselves in their identity as consumers. In fact, susceptibility for the first time to income taxes would leave them in a worse position. Temescal

was of the opinion that nonprofit rates would permit them to continue to enjoy their tax benefits despite their new status as a public utility. To insure nonprofit operation Temescal proposed a year-end determination of whether water revenues exceeded or failed to cover expenses, followed by either a refund or assessment of stockholder-consumers, depending upon the results, in order to achieve the nonprofit objective. Temescal's proposal is set forth in greater detail in Decision No. 65115 complained of here (Tem. R. pp. 25-29), and in this Commission's answer to the petition to the California Supreme Court, in which answer portions of Temescal's principal testimony and exhibit are quoted. (Tem. R. pp. 84-86.)

2. The Rate Proposal of the Commission Staff.

Ultimately approved and adopted by the Commission in Decision No. 65115 was the rate proposal of the Commission staff. The basis of that proposal is set forth in considerable detail in Decision No. 65115. (Tem. R. pp. 31-37.) The staff concluded first that the fixing of proper utility rates would necessarily have to await the completion by Temescal of the original cost and depreciation reserve requirement studies. It therefore proposed rates designed to bring in revenues and result in charges approximating those then being received from Temescal's irrigation and resale services (Tem. R. p. 31).

The staff proposal attempted to accommodate Temescal's stated objective of nonprofit rates. However, the staff proposal contemplated *fixed* rates since it could not accept the suggested device of a year-end assessment-refund provision by which Temescal sought to guarantee nonprofit operation. That provision constitutes, in effect, not only retroactive ratemaking, but retroactive ratemaking by the utility

itself and not with prior approval of the Commission charged by the statutes with the responsibility of fixing rates. Retroactive ratemaking is generally considered to be invalid unless authorized by statutes. (1 Davis, Admin. Law Treatise, § 5.08 (1958) pp. 340-1); *Public Util. Com. v. United Fuel Gas Co.*, 317 U.S. 456, 460-463, (1943); *Transcontinental & W. Air v. Civil Aero. Board*, 336 U.S. 601, (1949)). No such authority can be found in the California Public Utilities Code. Section 454 thereof does state in part as follows in so far as rate *increases* are concerned:

> "No public utility shall raise any rate, or so alter any classification, contract, practice, or rule as to result in any increase in any rate except upon a showing before the commission and a finding by the commission that such increase is justified."

This Commission has held unequivocally (*Re Pacific Tel. & Tel. Co.*, Decision No. 43145, 48 CPUC 823, 836 (1949)) that rates may not be fixed retroactively by the Commission itself, to say nothing of unilateral action of this nature by the public utility. It is the view of this Commission that the assessment-refund provision which Temescal proposed is contrary to the Public Utilities Code and its inherent concept of a fixed and determined rate for the future. This respondent was not disposed to discard or qualify that view in order to accommodate one company's plan to unilaterally vary its rates retroactively so that it might escape payment of federal income taxes.

3. The Evidence.

At page 3 of the petition for writ, under the heading "Questions Presented" appears the allegation that Decision No. 65115 "is not based on evidence or is contrary to evidence." If the first portion of this charge is intended to

mean there was *no* evidence to support the decision, we would first note that this claim was not made in the petitions to the California Supreme Court filed by petitioners herein (See grounds for review set forth in Tem. R. pp. 11-12 and St. R. pp. 7-8), and may not properly be raised before this court. (*California v. Taylor*, 353 U.S. 553, 557, n. 2 (1957); *Lawn v. United States*, 355 U.S. 339, 362, n. 16 (1958)).

If it is assumed that this issue is properly raised here, it would appear to have reference to the remark at page 4 of the petition for writ that there was nothing in the record to enable the Commission to establish a rate base or to determine water operating expenses alone. As to evidence of rate base, it is clear from paragraph I, 1, above, that this proceeding commenced with the understanding that the studies necessary for the determination of rate base had not been completed by Temescal—in fact, hardly commenced—despite the passage of a year and a half from the California Supreme Court's finding of public utility status, and that such evidence would have to await a further hearing.

As to evidence needed to determine water operating expenses alone, this was Temescal's failure. It is apparent from Decision No. 65115 (Tem. R. pp. 35-37) that Temescal's witness conceded that its figures did not include revenues from nonutility sources, but *did* include all expenses, including nonutility expenses. Temescal failed to produce evidence by which the Commission could determine water operating expenses alone. This was one of the principal causes for the rejection of Temescal's rate proposal and the acceptance of the staff proposed rates. As set forth in this Commission's answer to the petitions to the California Supreme Court (Tem. R. 89-91), Temescal's claim

at page 4 of the instant petition for writ, that the staff rate proposal would produce revenues for 1961 in an amount $40,547 short of expenditures, was necessarily rejected by the Commission because of Temescal's inconsistency in excluding nonutility revenues while including nonutility expenses. Also at page 4 of Temescal's petition to this Court is a reference to a figure of $77,440 applicable to the year 1962. That figure was not a part of the hearing record before the Commission, having been forwarded by Temescal in the form of an affidavit several months after the case was submitted, and was not subjected to cross-examination, test or rebuttal. (Tem. R. p. 91).

Also under the heading "Questions Presented" (page 2 of petition for writ) appears the claim that Decision No. 65115 requires Temescal to operate at a loss. That statement is misleading and inaccurate. Rates are ordinarily established for the future with the objective of producing sufficient revenues as will, in the judgment of the rate-making body, bring to the utility a specific authorized rate of return on its investment devoted to utility use. Since the process is performed prospectively, the facts of utility operation do not offer the prospect of exact attainment of the rate of return objective. Various factors which cannot be foreseen occur and affect operations. For example, water consumption may vary widely due to climatic conditions. Expenses such as wages, local taxes, material and supply costs may change substantially. Unanticipated capital expenditures may alter the rate base. While such changes occur, the authorized rates of necessity remain fixed until the next rate proceeding before the regulatory agency. Since ratemaking is not an exact science, it is apparent that when any rate of return is authorized the best hope can only be that the rate of return actually realized be as close as

possible to the goal. It may be more or it may be less. Perfection cannot be expected when rates are set prospectively.

Considerable judgment and expertise enter into the establishment of utility rates. This Commission utilized its judgment and expertise in selecting from conflicting proposals that *most likely* to achieve the requested goal of nonprofit operation, while yet adhering to recognized principles of prospective ratemaking. The best that could be hoped to be achieved prospectively would be results *substantially close* to Temescal's objective of nonprofit operation. The rates which were authorized here for Temescal are as likely to produce revenues which exceed expenses as they are to produce revenues which do not meet expenses. At the hearing one of Temescal's exhibits contained the following statement in support of the request for a nonprofit rate:

> "Inasmuch as the stockholder is the consumer, he cannot benefit by increasing the costs to himself in order that the company may pay him a return on his investment." (Tem. R. p. 85.)

A relevant inquiry would be whether or not the converse is not also true, i.e., that a stockholder-consumer in this situation is not damaged as a stockholder by a Temescal loss if that loss is traceable to lower water rates paid by him as a consumer.

This respondent submits that there is abundant evidence in the record on the merits and deficiencies of the respective rate-proposals. Decision No. 65115 contains lengthy recitals of such evidence. The Commission performed its duty as an expert regulatory body and authorized those rates which in its judgment were just, reasonable and most likely to achieve the requested nonprofit goal. It should be noted that Decision No. 65115 authorized rates which were intended to be temporary and interim in effect. The following appears in the decision (Tem. R. p. 37):

> "The staff's proposed rates and rules were hereby find to be reasonable and they will be adopted and placed in effect until Temescal is prepared to present evidence upon which a different set of rates and rules could be based."

It would have been preferable here to have had a full and complete showing; thus permitting in the first instance a more accurate determination of just and reasonable rates. However, it was Temescal's own failure to get its accounts in order and to make the necessary studies, despite the passage of a year and a half, which required the rates to be developed as they were. As heretofore noted Temescal agreed to this interim type proceeding. Ordering paragraph 2 of Decision No. 65115 (Tem. R. 38) requires Temescal to complete its studies of original cost, cost of service and depreciation prior to December 31, 1963. Upon such completion Temescal may, if it finds it has justification, come to this Commission for a revision. If Temescal concludes at that time that it prefers to receive a rate of return on its investment rather than accept rates calculated to return its costs alone—even if it has to pay income taxes—this Commission would be pleased to entertain the request.

II. Temescal's Claim That Decision No. 65115 Impairs the Obligation of Contract Is Not Properly Before This Court.

Temescal claims that Decision No. 65115 applies "rates and regulations" for water service which impair existing agreements, thus constituting a taking of property without due process (Petition for Writ, p. 2), and that such "private right in the price and terms" of water are not subject to public regulation (Petition for Writ, pp. 4-5).

Decision No. 65115 does not purport to determine or affect *contract obligations between Temescal* and its share-

holders, or the private rights claimed to be possessed by such shareholders. If such obligations or rights have been affected, they have been affected by this Commission's previous decision, Decision No. 59443 (page 1 of Appendix A to Petition for Writ), later affirmed by the California Supreme Court in 1969 in its *Corona* decision (p. 18 of Appendix A to Petition for Writ). Decision No. 59443 found that Temescal was a public utility water company and ordering paragraph 3 thereof ordered that the case be reopened so that rates and rules might be prescribed pursuant to this Commission's general rate jurisdiction over public utilities. (Article XII, Sec. 23, Constitution of the State of California, see Appendix B to petition for writ; Public Utilities Code of the State of California, Secs. 451-495.) It was the prior decision which subordinated any pre-existing contract rights possessed by Temescal shareholders to the Commission's rate jurisdiction and that decision is, of course, final and the issue of public utility status raised therein *res judicata*.

Even if it were assumed that the issue of the impairment of private contracts or rights has been properly raised in the instant petition for writ, it is obvious that the claim still lacks merit. The California Supreme Court has stated as follows in *Law v. Railroad Commission*, 184 Cal. 737, 739; 195 P. 423, 424 (1921):

> "It has been conclusively settled that the interference with private contracts by the state regulation of rates is but a legitimate effect of a valid exercise of the police power which neither impairs the obligation of a contract nor deprives of property without due process of law." (citing cases)

In *Midland Realty Co. v. Kansas City Power & Light Co.*, 300 U.S. 109, 113, 114 (1937), this Court held that a state

has power to annul and supersede rates previously established by contract between utilities and their customers. (See also *Producers Transportation Co. v. Railroad Commission of the State of California*, 251 U.S. 228, 232 (1920); *Union Dry Goods Co. v. Georgia Public Service Corp.*, 248 U.S. 372, 375 (1919); and *Manigault v. Springs*, 199 U.S. 473, 480 (1905)).

Joining in this petition for writ is James A. Stein, appearing in his own behalf and in behalf of 49 other shareholders, owning in total 4,343 shares of Temescal. This is approximately one-third of the outstanding shares. (Petition for writ, pp. 4-5; see also Tem. R. 95-96). Mr. Stein filed a separate petition for writ before the California Supreme Court (St. R. 1-9) which was denied simultaneously with the denial of Temescal's petition. The claim of impairment of contract obligations and rights is urged principally by Mr. Stein. It was the position of this Commission before the California Supreme Court that Mr. Stein and the shareholders he represents had no standing permitting them to file a separate petition for rehearing. (St. R. pp. 78-79). Since the injury complained of, if established, would affect all shareholders in the same manner and would not injure the 50 shareholders in a manner peculiar to them alone, the type of action contemplated would have been derivative in nature under California law. (*Sutter v. General Petroleum Corp.*, 28 Cal. 2d 525, 530; 170 P.2d 898, 900, 901 (1946); *Gagnon Co., Inc. v. Nevada Desert Inn*, 45 Cal. 2d 448, 453; 289 P.2d 466, 470, 471 (1955); 12 Cal. Jur. 2d. ¶ 213, 214, 215). A shareholder (or shareholders) has no right to bring an action in behalf of a corporation save in exceptional cases where the directors fail to act or are guilty of fraud. (12 Cal. Jur. 2d, ¶ 216.) The prerequisites of a derivative suit were not present before

the California Supreme Court, nor were they even claimed to exist. Lacking any status to appear before the California Supreme Court, Mr. Stein and his fellow shareholders similarly lack status to appear before this Court as parties distinguishable from the Temescal corporate entity. In any event, even if the shareholders had a valid right to separately appear here, the arguments above in answer to Temescal's claim of impairment of contract rights or obligations, would be equally applicable.

At page 6 of the petition for writ, *Allen v. Railroad Commission*, 179 Cal. 68, 175 p. 466 (1918), is cited, apparently in support of Temescal's claim that Decision No. 65115 is in derogation of existing private agreements. The reference does not appear to be relevant, being cited for the proposition that a water company may engage in part in public service and in part in private service and that the latter is not subject to regulation. With this we would not disagree. However, substantially all of Temescal's water was delivered to shareholders and it must be assumed that substantially all of its water production and distribution facilities are utilized for such service. Before the California Supreme Court Temescal did not claim any division of its properties, facilities or services. In *Corona City Water Company v. Public Utilities (supra)*, the court did not touch on the question of dual function or of a dedication in part only. Dedication was found as to the whole, and the opinion is final and the issue *res judicata*. The issue may not now be raised anew and relitigated under the guise of attacking a subsequent rate order of this Commission. Even now petitioners do not state where and how such a division of properties or activities could be made.

CONCLUSION

For the foregoing reasons the petition for writ of certiorari should be denied.

Respectfully submitted,

RICHARD E. TUTTLE
J. THOMASON PHELPS
MARY MORAN PAJALICH
HECTOR ANNINOS
Attorneys for Respondent Public Utilities Commission of the State of California and the People of the State of California

Dated: January 10, 1964.